

Property Insurance

Reinstatement Cost Assessments (RCA)



Property insurance is a vital safety net for property owners and investors protecting their property assets from unforeseen events. Underinsurance, however, can erode the value of that safety net with the Chartered Institute of Loss Adjusters estimating that underinsurance is present in over 40% of claims¹.

Introduction

Due to rapid inflation in both the costs of building materials and labour we have seen substantial rises in the cost to reinstate buildings following a loss. Therefore, there is a risk of underinsurance where the building sums insured have not been reviewed in recent years. To avoid the risk of having a shortfall in the insurance payout in the event of a claim, it is essential to regularly review the adequacy of building reinstatement costs. Equally, being overinsured poses the risk of paying too much insurance premium.

This Risk Topic focuses on the pitfalls of underinsurance and the different elements to consider ensuring your property reinstatement values are up-to-date and include all the necessary considerations.



Key Questions

The questions below provide a quick reference check regarding the accuracy of your building sums insured:

1. Have you had a Reinstatement Cost Assessment (RCA) for your building completed in the last three years?
2. Has a RICS (Royal Institute of Chartered Surveyors) Member assessed your property?
3. Are your building sums insured reviewed annually for inflation and updated?
4. Have there been any changes to your property since the last RCA was carried out?
5. Have you considered the impact of VAT and the building sum insured?
6. Does your building have any specialist features that require careful consideration e.g., a Listed building or the presence of any unusual design features?

Property Insurance & RCAs

Property insurance will cover the costs of rebuilding and repairing in the event of a loss. A Reinstatement Cost Assessment (RCA) calculates the cost to replace and rebuild a property in the event of a loss. Having an accurate RCA is vital to ensure your property is adequately insured.

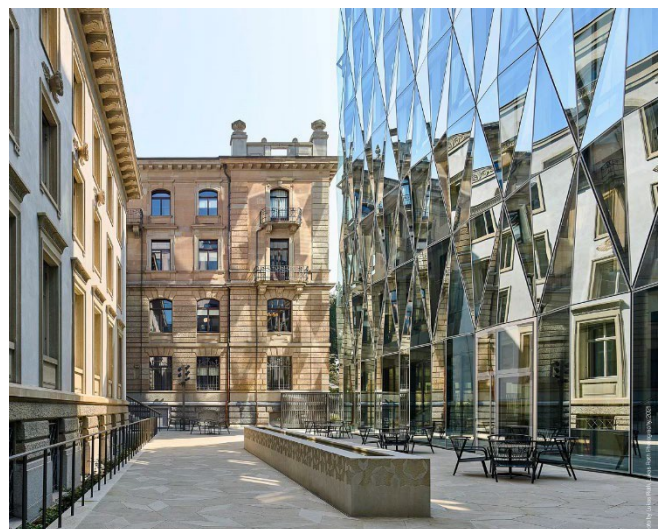
Underinsurance

Underinsurance occurs when cover is set too low to sufficiently meet the costs of rebuilding. This can expose the property owner to a significant financial shortfall in the event of a claim. As an insurer, we are committed to supporting our customers in setting the appropriate building sum insured so we can avoid this situation from happening.

Condition of Average

In circumstances where a property owner is underinsured the claim payout will be reduced in proportion to the level of underinsurance. For example, in the worked example below the level of underinsurance is 50% with the claim payout reduced by 50% as a consequence.

Declared Value	Actual Value	Under Insurance	Claim Value	Claim Settlement
£500,000	£1 million	50%	£200,000	£100,000



Key Reasons for Underinsurance

- **Inaccurate Property Valuations**
- **Rising Construction Costs**
- **Index Linking & Uplifts Falling Behind**
- **Lack of Professional Assistance**
- **Infrequency of Valuations**



Case Study

A customer had three separate buildings each insured for a Declared Value below £5m million. Following full RCAs, these Declared Values were found to be seriously underinsured and were increased from £15 million to £50 million. While this level of underinsurance is unusual it does demonstrate the value of having a Reinstatement Cost Assessment carried out by a qualified professional.

Inflation

According to the Building Cost Information Service (BCIS) Building Forecast² over the next 5 years (2Q2024 - 2Q2029):

- Materials prices are expected to rise by 15%.
- Tender prices expected to rise by 19%.
- Skills shortages continue to drive labour costs, with an expected overall 17% increase, adding to overall project costs. Workforce is 90% of pre-pandemic levels, with already long-standing concerns around fulfilling skill requirements.
- Annual growth, whilst negative for the past two quarters, is expected to increase by 14%.

Impact of Climate Change

With changes to building regulations aiming to reduce CO₂ emissions in construction and delivering net zero, we anticipate there will be an associated rise in costs. It is currently estimated to achieve the target of reducing greenhouse gas emissions from public buildings by 75% by 2037 will cost in excess of £25bn³.

These associated costs will continue to evolve and need to be taken into account when setting building sums insured. If these costs are not adequately considered it increases the risk of underinsurance. Not only will this impact new construction projects, but it will also have a significant impact on the retrofitting of all building types.

Placing the Correct Insurance

When calculating the appropriate building sum insured this needs to take into account the following allowances:

- Foundations
- External works or structures
- Professional fees
- Demolition and debris removal fees
- Planning and building regulation fees

A qualified RCA assessor will take into account the above allowances.



Case Study

A customer suffered a shortfall after mistakenly excluding VAT. The customer involved believed that they were VAT exempt as the customer's activities were not-for-profit. When examining more closely it was found profit making activities were happening and so VAT did apply and should have been included in the sum insured. This resulted in underinsurance and the condition of average applied. It reinforces the need to take professional advice when setting the building sum insured.

VAT

Misapplying or misunderstanding VAT is a common issue. Some aspects of a building's reinstatement may attract VAT whilst others might not, and the position can vary depending on each organisation's tax arrangements. We strongly advise that you should always seek advice from your tax advisor before excluding VAT from the building's declared value.

Please note that a building's market value must never be used for placing building insurance. Using the market value may result in the property being either over or under insured.

Declared Value

Building sums insured need to reflect the full cost of reinstating a building following a total loss on a 'Day One' basis. Each building will have features that can significantly alter a reinstatement cost, such as difficult site access, period features or specialist construction techniques. A qualified surveyor will have the expertise to identify and quantify these factors, and one should always be engaged when establishing sums insured for insurance purposes.

Property values vary over time which is why annual reviews of all sums insured are important to ensure your insurance covers the current value of reinstatement. This does not have to be a full professional survey every year. The Royal Institute of Chartered Surveyors (RICS) recommends at least every 3 years with annual desktop reviews in between for professionally informed valuation updates in line with inflation.

Material changes to a buildings make-up, for example an extension, should be followed by a professional assessment to ensure your building sum insured remains adequate.

Professional Guidance

It is always recommended to seek professional advice to help establish accurate declared values. These fees are considered to be an essential expenditure to avoid the potential financial shortfalls that underinsurance can cause following a loss. Some of today's policy wordings will remove the condition of average clause when declared values have been calculated by qualified professional surveyors, therefore eliminating the risk of underinsurance, and enhancing the value of such services.

When seeking professional advice, it is important to ensure the individual has a relevant degree or professional qualification approved by the Royal Institute of Chartered Surveyors (RICS)⁴ in a subject such as surveying, construction, civil engineering, building engineering or quantity surveying.

RICS regulated surveyors will adhere to the RICS professional standards and guidance document – Reinstatement Cost Assessment of Buildings.



Zurich Resilience Solutions (ZRS) Services

ZRS have an in-house team of specialist surveyors able to undertake Reinstatement Cost Assessments. Please contact us via our email address to discuss your needs: zrs.valuations@uk.zurich.com

Our experienced team, led by RICS qualified surveyors, will prepare a cost analysis on an elemental cost basis rather than general rebuild values. This methodology allows for accuracy of the assessment which is vital for insuring the property.

We can complete on-site assessments, portfolio healthchecks and desktop reviews depending on your needs.

For further information please see our proposition document on ZRS Marketplace: <https://zrsmarketplace.zurich.com/uk/s/reinstatement-cost-assessments>

References & Further Reading

1. <https://www.zurich.co.uk/news-and-insight/comprehensive-guide-avoiding-underinsurance>
2. BCIS 5 year building forecast 1Q2024 to 2Q2029: <https://bcis.co.uk/news/bcis-construction-industry-forecast/>.
3. <https://www.bbc.co.uk/news/uk-politics-63514562>
4. <https://nationalcareers.service.gov.uk/job-profiles/building-surveyor#:~:test=You%20could%20do%20a%20chartered,to%20gain%20chartered%20surveyor%20status.>
5. Zurich White Paper 'A Comprehensive Guide to Underinsurance': <https://www.zurich.co.uk/news-and-insight/comprehensive-guide-avoiding-underinsurance>

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